



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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08-13-07

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In the Matter of Application of
CALIFORNIA-AMERICAN WATER
SERVICE COMPANY (U 210 W) for an
order authorizing it to increase its rates for
water service in its Los Angeles District to
increase revenues by \$2,020,466 or 10.88% in
the year 2007; \$634,659 or 3.08% in the year
2008; and \$666,422 or 3.14% in the year
2009.

A.06-01-005
(Filed January 9, 2006)

**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES
ON ALTERNATE PHASE ONE PROPOSED DECISION**

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August 13, 2007

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CERTIFICATE OF SERVICE

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**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES
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I. INTRODUCTION

Pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure (Rules), the Division of Ratepayer Advocates (DRA) submits these Comments on the 7/24/07 Alternate Proposed Decision adopting the revenue requirement for California-American Water Company's (Cal-Am's) Los Angeles District (Alternate Proposed Decision or Alternate).

DRA continues to support the Proposed Decision of ALJ Walwyn mailed 5/7/07 (Walwyn PD). Thus, DRA also supports those aspects of the Alternate Proposed Decision that remain unchanged from ALJ Walwyn's Proposed Decision, including:

- Adopting the partial settlement between DRA and Cal-Am on certain revenue requirement issues.
- Establishing a return on equity (ROE) of 10.0%.
- Requiring certain limitations and customer safeguards as part of the Distribution System Infrastructure Charge (DSIC) granted for routine infrastructure replacement.
- Imposing a penalty on Cal-Am for repeated violations of the notice requirement of Commission Rule 24.

While the Walwyn PD establishes a return on equity (ROE) adjustment of .50% in the event that the parties' Settlement Agreement on Rate Design Issues (Rate Design Settlement or Phase II Settlement) is adopted in Phase II of this proceeding,¹ the Alternate Proposed Decision concludes that it is "premature" to consider certain elements of the Rate Design Settlement (such as the Water Revenue Adjustment Mechanisms (WRAMs)) and whether an ROE adjustment should be associated with that settlement.² Instead, the Alternate introduces into the record for the first time the concept of a Conservation Loss Adjustment Mechanism (CLAM), identifies a CLAM as the Commission's "policy preference," and "encourages" the parties to negotiate a CLAM in lieu of a WRAM.³

The Alternate's conclusion that a CLAM is the Commission's preferred policy constitutes legal error because it is not supported by the record, is arbitrary and capricious, and violates the parties' due process. DRA therefore recommends that the entire discussion of the CLAM be eliminated from the Alternate. Instead, DRA recommends one of the following options:

(1) DRA continues to support the WRAMs, modified cost balancing accounts (MCBAs), and conservation rates of the Phase II Rate Design Settlement negotiated with Cal-Am, and recommends adoption of the Walwyn PD.

(2) If the Commission believes that the ROE adjustment issue should be addressed in an industry-wide proceeding, DRA recommends that the Commission still allow consideration of the Rate Design Settlement in Phase II of this proceeding, and incorporate into Phase 1B of the Conservation OII (I.07-01-022) consideration of any associated ROE adjustment.⁴

¹ Walwyn PD at 31-41.

² Alternate at 2-3, 34.

³ Alternate at 35-37.

⁴ The scope of Phase 1B of I.07-01-022 includes consideration of an ROE adjustment with regard to the conservation rate design mechanisms of Suburban Water Systems, Park Water Company, California Water Service Company, San Jose Water Company, and Golden State Water Company. Administrative

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(3) If the Commission believes that it is also premature to consider a WRAM and other regulatory accounting mechanisms associated with conservation rate designs, the Commission should adopt those elements of the Alternate that are in common with the Walwyn PD, and close this proceeding after ordering Cal-Am to file a conservation rate design proposal for the Los Angeles District in the Conservation OII (I.07-01-022) to be dealt with in Phase 1B of the OII.

II. BACKGROUND

This proceeding has been bifurcated into two phases, with the first phase addressing the revenue requirement for Cal-Am's Los Angeles district, and the second phase addressing rate design. In Phase I, Cal-Am and DRA proposed a partial settlement on revenue requirement, and litigated contested issues including (1) Cal-Am's proposed Infrastructure System Replacement Surcharge (ISRS) and (2) DRA's proposed adjustment to the company's return on equity (ROE) if the Commission adopts the settlement on conservation rates and balancing accounts that the parties have proposed in Phase II of this proceeding.

In Phase II of this proceeding, Cal-Am and DRA negotiated a rate design for the Los Angeles district that would implement conservation rates for all customers such that the quantity rates in the summer would be higher than those at other times during the year. Residential customers would also have "inverted block rates" in which the quantity rate increases as consumption amounts increase. In addition, the Phase II settlement would adopt a Water Revenue Adjustment Mechanism (WRAM) for each service area in Cal-Am's Los Angeles district that decouples revenues from sales. The Phase II settlement would also replace the existing cost balancing accounts for purchased power and purchased water, which only track cost variations due to changes in unit price, with

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Law Judge's Ruling Consolidating Application of San Jose Water, Modifying Schedule, and Addressing Phase I Hearings, I.07-01-022 (May 29, 2007) at 3-5.

Modified Cost Balancing Accounts (MCBAs) that track cost variations due to changes in both unit price and consumption.

Dealing only with Phase I issues, the Proposed Decision issued by ALJ Walwyn on May 7, 2007 adopts the partial settlement on revenue requirement, with some modifications, and resolves the issues remaining in dispute as follows:

- (1) the PD rejects Cal-Am's proposed Infrastructure System Replacement Surcharge (ISRS), but adopts a Distribution System Infrastructure Charge (DSIC) program with certain requirements, limitations, and customer safeguards,
- (2) the PD determines that Cal-Am's return on equity should be reduced by .50% if the Commission adopts WRAMs and MCBAs in Phase II, and;
- (3) the PD imposes a fine of \$11,000 for Cal-Am's violations of certain Commission notice provisions.

The Alternate Proposed Decision eliminates the discussion of any ROE adjustment that may result from adoption of a WRAM.⁵ Instead, the Alternate supports consideration of WRAMs, MCBAs, and any associated ROE adjustment in an "industry-wide proceeding," and encourages Cal-Am and DRA to instead negotiate a Conservation Loss Adjustment Mechanism (CLAM) which, according to the Alternate, would not require an ROE adjustment.⁶

III. THE ALTERNATE'S STATEMENT OF PREFERENCE FOR A CONSERVATION LOSS ADJUSTMENT MECHANISMS AMOUNTS TO TECHNICAL AND LEGAL ERROR

The Alternate encourages DRA and Cal-Am to develop what it refers to as "a conservation loss adjustment mechanism that is focused solely on cost under and over-recovery caused by [the Commission's] conservation policies."⁷ The Alternate expresses

⁵ While the Alternate did not initially include discussion of an ISRS/DSIC, a corrected version of the Alternate was distributed to the service list on August 9, 2007 that reincorporated the ISRS/DSIC section from the Walwyn Proposed Decision.

⁶ See, e.g., Alternate at 3, 34, and 37.

⁷ Alternate at 35.

a preference for this approach “because it directly supports [the Commission’s] conservation goals and it will not require continuous litigation of an ROE adjustment,”⁸ and envisions a CLAM with the following technical elements:

- (a) A balancing account in which to record the overcollection or undercollection of authorized fixed costs due to differences caused by the adoption of a Phase II conservation rate design;
- (b) A clear methodology for tabulating and verifying changes in water volume sales due to conservation measures;
- (c) A recovery mechanism for fixed cost underrecovery from customer usage reductions directly attributable to new conservation programs implemented by Cal-Am in the test period.⁹

The Alternate’s conclusion that the CLAM is the preferred mechanism when implementing conservation rate designs is factually and legally erroneous.

A. Technical Errors in the Alternate

First, while the Alternate accurately states that the intent of the WRAM in Cal-Am’s Monterey District (Monterey WRAM) is to “capture revenue shifts that are caused by inverted-block conservation rate design,” it incorrectly concludes that “[t]he mechanism that has protected Cal-Am from variations in cost recovery resulting from its conservation rate design in its Monterey District would meet the first criteria above.”¹⁰ The Monterey WRAM captures revenue shifts by comparing the revenue realized for the actual quantities sold under the increasing block conservation rates, and what Cal-Am would have realized if the same actual quantities used by ratepayers were sold under a standard rate design. Unlike the Monterey mechanism, which compares only authorized revenue and actual realized revenue, the proposed CLAM would instead compare authorized revenue to actual fixed costs recovered. DRA notes that, as a policy matter,

⁸ *Id.*

⁹ Alternate at 35-36 (emphasis added).

¹⁰ Alternate at 36.

balancing adopted revenue with actual fixed cost is problematic. For example, it removes any incentive for Cal-Am to operate under the Commission's approved cost structure.

Second, even if the proposed CLAM compared adopted revenues to actual revenues, as opposed to adopted revenues to actual cost, the CLAM, from a technical perspective, could not meet elements (b) and (c) listed above. These elements pose a technical challenge that would be very difficult to overcome in that they require an evaluative analysis that is not possible. Elements (b) and (c) require the attribution of cause and effect to a statistical analysis, specifically correlation, that is only capable of determining the strength and direction of a linear relationship between two random variables. While statistical analysis can help us quantify a relationship by assigning a correlation coefficient to two events – conservation rates or programs, and water usage – statistical correlation is, by its nature, limited to a measure of the probability of two events influencing one another, but cannot be used to attribute cause and effect between two events.

Thus, the CLAM would require parties to identify the decreased usage that is directly attributable to conservation rates and programs, a cause and effect analysis that is beyond the capability of statistical tools (such as correlation) traditionally used to evaluate conservation programs including conservation pricing. One could attempt to extend statistical correlation to causation by, for example, adopting a mechanism that used correlation within a range of certainty or, as the Alternate PD recommends, “using estimates...at the lower end of published ranges.”¹¹ These approaches would require additional factual evidence not currently in the record. Furthermore, as a public policy matter, the resulting “estimates that would be reviewed in the next GRC”¹² are likely to be the subject of considerable review and litigation, unlike the balances of the regulatory accounts that the Phase II Settlement would adopt, which do not involve estimates.

¹¹ Alternate at 36.

¹² Alternate at 37.

Finally, in addition to the challenge of establishing cause and effect for conservation rates, or a proxy thereof, developing the CLAM proposed in the Alternate would require the parties to:

- Identify conservation programs currently in place and estimate their associated conservation effects;
- Develop new conservation programs to implement during the test period and estimate their associated conservation effects;
- Establish metrics, data collection, program reporting, and data validation processes, and;
- Calculate the fixed costs that are under-recovered.

These activities would be time-consuming and highly technical. While the Alternate favors considering WRAM and ROE in an industry-wide proceeding, any consideration of a CLAM should be deferred until after the above issues can be thoroughly reviewed by the Commission in an industry-wide proceeding, perhaps through workshops in which a common understanding and standards could be established. In fact, the Commission is currently considering the scope of Phase II of I.07-01-022 and has scheduled a workshop to select and prioritize issues appropriate to this phase. Included in the items for discussion at this workshop are the California Urban Water Conservation Council (CUWCC) “Best Management Practices” (BMPs) and “Adopting Goals, Performance Metrics and Reporting Requirements for Non-Price Conservation”¹³. DRA estimates it would take one to two years to have a meaningful evaluation, measurement and verification framework in place such that a CLAM would even be possible. DRA recommends the Commission move forward with consideration of goals, performance metrics and reporting requirements in the OII, and dismiss any consideration of a CLAM as premature at this time.

¹³ Email from ALJ Grau, August 19, 2007, 3:13 p.m. to inform parties in I.07-01-022 that a Phase 2 workshop is scheduled to discuss possible Water Conservation OII Phase 2 issues on Wednesday, August 22nd, from 10 a.m. to 3 p.m. (lunch break from 12-1) in the CPUC auditorium. The email includes a listing of topics to discuss in Phase 2.

B. Legal Errors in the Alternate

The record does not support the Commission's adoption of a CLAM as a policy preference. The CLAM was not part of Cal-Am's original GRC application. Neither DRA nor any other party proposed a CLAM or any elements of a CLAM, and the scope of the proceeding was not modified to include a CLAM or elements of a CLAM. Thus, parties did not submit testimony on any of the many technical issues discussed above that would be necessary to develop a CLAM. Without a factual record on the CLAM proposed in the Alternate, the development of which raises many complexities and concerns, there is no basis for a Commission decision expressing a preference for a CLAM. A decision not based on the evidentiary record would therefore be arbitrary and capricious. Furthermore, since neither DRA nor other parties have been afforded an opportunity to address the technical aspects and public policy merits/drawbacks of a CLAM, such a decision would deny DRA and other parties both procedural and substantive due process.

C. Return On Equity (ROE)

The Alternate PD concludes that, "[i]f Cal-Am and DRA modify the pending Phase II settlement to replace the proposed WRAM with a conservation loss adjustment mechanism that meets the criteria discussed here, an ROE adjustment would not be necessary."¹⁴ As with the Alternate's statement of preference for a CLAM, a conclusion on the ROE adjustment or lack thereof that should be associated with a CLAM is unsupported by the record, arbitrary and capricious, and violates due process. If the CLAM itself has never been proposed or been the subject of testimony or cross-examination, then it would be impossible to determine the effect of a CLAM on ROE.

DRA also notes that the logic in the Alternate itself supports the possibility that an ROE adjustment may in fact be appropriate for a CLAM. The Alternate describes its

¹⁴ Alternate at 37.

preferred CLAM as being “narrower” than the WRAM negotiated by the parties.¹⁵ As discussed above, the Monterey WRAM does not meet any of the 3 elements of a CLAM that are articulated by the Alternate. In fact, the Monterey WRAM is even narrower than the proposed CLAM. Thus, while the Monterey WRAM did not result in an ROE adjustment, and a broader “full” WRAM “has an associated adjustment to ROE,”¹⁶ it is conceivable that a CLAM, a mechanism that is broader than a Monterey WRAM and narrower than a full WRAM, could merit a modest ROE adjustment.

IV. NEXT STEPS

As discussed above, the Alternate’s discussion of a CLAM should be eliminated. DRA therefore recommends that the Commission consider one of the following options.

First, DRA continues to support the Settlement Agreement on Rate Design Issues proposed by the parties in Phase 2 for the reasons discussed in the Motion to adopt the settlement. As discussed in DRA’s comments and reply comments on the Walwyn PD, DRA also supports the Walwyn PD with some modifications, and particularly supports the PD’s determination that adoption of the parties’ proposed WRAM merits a .50% reduction in Cal-Am’s ROE.¹⁷

Second, to the extent that the Commission determines that the appropriate impact of a WRAM on ROE should be addressed in an industry-wide proceeding, DRA recommends that the Commission adopt the Phase 2 Settlement and defer consideration of the ROE impact to Phase 1B of I.07-01-022. Both the Commission and the parties expended considerable time and effort analyzing different conservation rate designs, and the parties themselves engaged in extensive negotiations to reach the proposed Phase 2 settlement. Adopting the Phase 2 settlement while deferring the ROE issue to a different

¹⁵ Alternate at 35.

¹⁶ Alternate at 34.

¹⁷ Comments of the Division of Ratepayer Advocates on Phase One Proposed Decision (May 29, 2007).

proceeding would capitalize on these efforts and ensure that conservation rates for the Los Angeles District would be implemented soon.

Third, if the Commission believes that both WRAM (and other regulatory accounting options) and ROE should be dealt with in a proceeding with broad industry involvement, the Commission should adopt a Phase 1 decision that resolves Cal-Am's revenue requirement for the LA District and Cal-Am's request for ISRS, and should require the company to file a conservation rate design proposal in the Water Conservation OII (I.07-01-022). In Phase 1A of I.07-01-022, DRA entered into settlements that include conservation rates and WRAMs with three companies.¹⁸ Two of those settlements contain WRAMs that are substantially similar to that proposed in the Rate Design Phase II Settlement for the Los Angeles District.¹⁹ Furthermore, DRA will likely be entering into settlements with two additional companies in Phase 1B of I.07-01-022. Addressing Cal-Am's conservation rate design in I.07-01-022 will promote consistency in the Commission's consideration of these issues and increase efficiency.

Assuming that the schedule for Phase 1B of the OII is extended as requested by DRA,²⁰ Cal-Am's rate design proposal could and should be considered in Phase 1B of the OII. In order to adopt conservation rates, the appropriate regulatory accounting mechanisms, and a finding on ROE impact before Cal-Am's summer rates go into effect next year, and to take advantage of the imminent Phase 1B of the OII, DRA urges the

¹⁸ Motion of the Division of Ratepayer Advocates and Suburban Water Systems To Approve Settlement Agreements (Settlement Agreements Attached) (April 24, 2007) (4/24/07 Motion), Appendix A (Suburban Rate Design Settlement); Motion Of The Division Of Ratepayer Advocates And Park Water Company To Approve Settlement Agreement (June 15, 2007), Settlement Agreement Between The Division Of Ratepayer Advocates And Park Water Company On WRAM & Conservation Rate Design Issues (Park Rate Design Settlement); Motion Of The Utility Reform Network, The Division Of Ratepayer Advocates, And California Water Service Company To Approve Amended Settlement Agreement (June 15, 2007), Amended Settlement Agreement Between The Utility Reform Network, The Division Of Ratepayer Advocates, and California Water Service Company (Cal Water Rate Design Settlement).

¹⁹ Suburban Rate Design Settlement; Park Rate Design Settlement.

²⁰ See proposed modifications to Phase 1B schedule that DRA served on all parties in I.07-01-022 on August 1, 2007.

Commission to require that Cal-Am submit its conservation rate proposal in I.07-01-022 as soon as possible.

V. CONCLUSION

For the reasons discussed above, DRA urges the Commission to eliminate the discussion of a Conservation Loss Adjustment Mechanism from the Alternate, and to instead adopt one of DRA's recommendations, which include adopting the Walwyn PD, deferring consideration of an ROE adjustment to Phase 1B of the Conservation OII, or requiring Cal-Am to present its conservation rate design proposal for consideration in Phase 1B of the Conservation OII.

Respectfully submitted,

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August 13, 2007

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APPENDIX

PROPOSED MODIFICATIONS TO ALTERNATE PD

Findings of Fact

~~18. The Phase 2 adoption of a conservation loss adjustment mechanism rather than a WRAM is the Commission's policy preference for Cal-Am's Los Angeles District pilot conservation program. An adjustment mechanism that reflects conservation losses only should have no impact on ROE. We encourage Cal-Am and DRA to consider modifying their pending Phase 2 settlement to include a mechanism that provides:~~

- ~~a. A balancing account in which to record the undercollection or overcollection of authorized fixed costs due to differences caused by the adoption of a Phase 2 conservation rate design;~~
- ~~b. A clear methodology for tabulating and verifying changes in water volume sales due to conservation measures.~~
- ~~c. A recovery mechanism for fixed cost underrecovery from customer usage reductions direction attributable to new conservation programs implemented by Cal-Am in the test period.~~

Conclusions of Law

~~7. The objective of a conservation loss adjustment mechanism is to ensure Cal-Am does not undercollect its authorized fixed costs due to conservation rate design and new conservation programs and to ensure ratepayers are protected from any overrecovery of authorized costs that are due to the conservation rate design. Such a mechanism is more narrow and focused than a revenue adjustment mechanism and, therefore, would not require a downward adjustment to ROE.~~

7. A conservation rate design for Cal-Am's Los Angeles District, any associated regulatory accounting mechanisms, and any associated ROE adjustment should be considered in an industry-wide proceeding.

ORDER

IT IS ORDERED that:

10. Cal-Am is ordered to file a conservation rate design for the Los Angeles District in I.07-01-022 (Conservation OII) within 30 days of the effective date of this order.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of “**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON ALTERNATE PHASE ONE PROPOSED DECISION**” in **A.06-01-005** by using the following service:

☒ **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

☐ **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses, if any.

Executed on **August 13, 2007** at San Francisco, California.

/s/	NANCY SALYER
Nancy Salyer	

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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